

Wellesley Municipal Light Plant, Massachusetts

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Credit Profile

Wellesley Mun Light Plant ICR

Long Term Rating

AA/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA' issuer credit rating (ICR) on Wellesley Municipal Light Plant (WMLP), Mass.

The 'AA' rating reflects:

- A business profile of '2' on Standard & Poor's 10-point scale where '1' is the highest score attainable,
- Strong financial performance,
- An affluent service area that allows for rate flexibility, and
- No outstanding debt and a manageable \$14.5 million capital improvement program (CIP) through fiscal 2011 that is expected to be largely cash-funded.

The expectation that WLMP's rates will continue to be highly competitive despite significant increases as management proactively responds to the expiration of favorable power supply contracts.

These strengths are tempered by:

- Modest concentration in the customer base, with the 10 leading customers accounting for 31% of revenues.
- Increased, but manageable fixed costs associated with new power supply and entitlement contracts.

The business profile of '2' reflects a prudent and proactive management team, sound operations, a supportive state regulatory environment, and a strong competitive position—the latter partly due to WMLP's favorable rates and zero debt position.

WMLP provides electric service to more than 9,970 mostly residential customer meters in Wellesley (GO rating 'AAA'/Stable) and other unincorporated areas. Although the 10 leading customers are concentrated, concern regarding concentration is mitigated by the stability of the leading customers, many of whom would be unlikely to relocate. The risk that some of these entities could self-generate is always a possibility—in fact, Wellesley College has its own cogeneration facility. However, the town has indicated that it maintains extremely good relationships with its major customers, who are pleased with both the cost and reliability of service. Leading customers include Babson College, Wellesley Office Park Assn., and SunLife Financial.

Wealth and income levels in the town are a very high 181% of state levels and 218% of national levels as measured on a median household effective buying income basis. Unemployment rates are extremely low, well below the state and national averages.

The utility has no generation facilities of its own and purchases the bulk of its power through an "all requirements" take-and-pay contract with Constellation Energy Commodities (CEC), which went into effect June 1, 2002. The contract, which calls for very favorably priced power, remains in effect until Sept. 30, 2007.

Under the CEC contract, WMLP currently has a very favorable power supply portfolio and rate payers have enjoyed the benefits of some of the lowest rates in the state, with less than half the rates charged by neighboring municipal utilities. However, with the expiration of the CEC contract, power costs will rise significantly. WMLP's management has proactively secured replacement power and has sought to avoid rate shock by adopting phased-in rate increases in advance of the effective date of the new power supply contracts.

Under the CEC contract, WMLP currently receives power at a low 4.5 cents per kilowatt-hour (kWh). WMLP also receives a small amount of low-cost power from New York State Power Authority; total power costs measured 4.4 cents/kWh in 2006. WMLP has entered into roughly one dozen staggered and layered energy and capacity purchase contracts to meet the bulk of its power supply needs over the 2008-2012 period. In April 2007, WMLP locked in fixed prices for 40% of its power supply needs with Integrys and 40% of its needs with Constellation. The remaining 20% is currently left open for market purchases. WMLP has purchased a 10% entitlement on Braintree Electric Light Department's new Watson unit, a 115 MW dual-fired oil and gas unit expected to be placed into service on a brownfield site in March 2009. The entitlement runs for a 20-year period, with WMLP option to extend for one or more five-year periods. With the new power supply in place, management projects that power costs will virtually double.

Seeking to avoid rate shock, WMLP began initiating rate increases 21 months prior to contract expiration, instituting a 5% increase in January 2006 and a 10% increase in January 2007, with these rate increases covering 40% of the expected increase in power costs. The remaining 60% of power costs are expected to be covered by already approved rate increases of 1% per month over the February 2007 through March 2010 period. In total, management expects to have raised rates 47% over the September 2006 through June 2011 period. Yet despite these increases, WMLP's rates are expected to remain highly competitive and well below the area investor-owned utility NSTAR.

Although deregulation was signed into law in Massachusetts in 1997, public power systems in the commonwealth operate in a very supportive regulatory environment. Public power systems have the option, under Massachusetts' legislation, to prohibit retail choice in their service area as long as they are not selling generation service to customers outside their territory. By 2003, however, the

commonwealth required public power systems that have not offered retail choice to engage in a retail choice study. Under current legislation, municipal entities are required to do no more than engage in the study; they are not required to open up their service area. WMLP has not opened its service area for retail choice but is well positioned to compete in a retail access environment given the utility's strong financial performance; zero debt position; rates that are currently competitive and expected to be even more so in the future; current cost-cutting initiatives; and good relationships with its major customers.

WMLP has a track record of strong financial performance. The utility generated net income of \$4 million fiscal 2006 prior to depreciation and payments in lieu of taxes of \$1 million to the town. The coverage level of estimated capacity payments associated with purchased power after the pilot payment was strong at 1.7x. Liquidity is robust at 233 days' worth of operating cash available at fiscal year-end 2006. WMLP has identified \$14.5 million in capital projects over the next several years, and expects to internally fund the bulk of the spending projects.

Outlook

The stable outlook reflects the expectation that the utility will maintain competitive rates, continue to have sound operations, and generate strong financial performance.

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